

Alternative Investment Fund Regulation

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Wolters Kluwer ISBN 978-90-411-3690-9

Alternative funds- hedge funds- private equity funds - AIFMD –sovereign wealth funds

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Preface

This book reflects the reports presented at the XVIIIth International Congress of the International Academy of Comparative Law, held in Washington on the 29 July 2010 on the subject of ‘The regulation of private equity, hedge funds and state funds’.

It contains a wealth of information on the different approaches and the specific regulations that national legislators have adopted on essentially the subjects of hedge funds and private equity funds.

Both types of funds have been in the centre of the public interest and in Europe of the sometimes sharp controversies during the ongoing financial crisis. Some have considered these funds to be at the roots of the crisis as having created massive systemic risk, an allegation that is difficult to support in light of the subsequent research. Others have drawn attention to the social impact of these funds, whether as activist investors challenging the incumbent management of well-established companies, or by aggressively intervening in the business organization of a firm, sometimes imposing incisive decisions on its financial structure or its employment. A third level of criticism is supported by stronger evidence, and relates to the excess returns some of these funds achieved even during the crisis. But in some, exceptional cases it appeared that these results were less due to their superior knowledge of the financial markets, but rather are to be attributed to advance information on significant events or developments in listed companies, information obtained through insider rings or other social networks.

These and more political concerns raise the question whether stricter regulation should apply to these funds and the actions they undertake. If in many jurisdictions they generally were exempt from much of the regulation, the present report illustrates that this was not generally the case, and that several states had adopted sometimes stringent rules avoiding these products to be offered to the retail investor, or at least providing safeguards that would limit the investor’s risk (e.g., by allowing only ‘funds of funds’). But a general view on the risks created by these alternative funds was difficult to

establish: only through the banks' financing of these funds (usually by the 'prime broker') could public authorities obtain an insight into their financial position, and hence the risks these funds could introduce in the wider financial system.

The present crisis has fundamentally challenged the latter approach. Regulators and supervisors have become aware that their lack of reliable and comprehensive data about the activities of these alternative funds – part of the 'shadow banking system' – could create significant hidden risks in the financial system, and potentially lead to systemic concerns. As a consequence, measures were adopted both in the European Union – the Alternative Investment Management Funds Directive – and to a lesser extent in the United States to impose a risk sensitive framework, allowing if necessary to curb their 'risk appetite'.

But equally important and certainly more important for legal practice is the finding that as far as investor protection is concerned, much of what was in place will be maintained, and that the new regulations have not substantially modified the pre-existing scheme. Therefore, the national reports, reproduced in this book and updated for more recent developments, retain their full value.